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June 16, 2004

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Subject: Concept Release: Securities Transactions Settlement
[Release No. 33-8398; 34-49405; IC-26384; File No. S7-13-04]

Dear Mr. Katz:

The Bond Market Association* (the "Association") appreciates this opportunity to submit these comments regarding the above-captioned Concept Release relating to Straight Through Processing ("STP") in the securities markets. We would like to commend the Securities and Exchange Commission (the "SEC" or "Commission") for raising in the Release salient questions concerning STP. The resolution of these questions will help provide further direction to the securities industry concerning safe and efficient operational procedures for clearance and settlement.

As noted below, the fixed income securities industry has achieved numerous goals in recent years in the STP area. However, because technology lends itself to continuing enhancements, STP is a task that never really ends. Accordingly, we feel that the SEC's Release will facilitate a timely process of prioritizing the STP steps which the Wall Street community needs to achieve in order to continue to streamline its securities processing infrastructure.

<u>The Association's Role in Securities Processing and STP</u>

The Association has sponsored the development of major fixed income securities operations initiatives since its inception. For example, we have served as a commenter on many operational rule proposals of self-regulatory organizations. In addition, the Association worked with other Wall Street leaders to implement the change from T + 5 to T + 3 settlement. Currently, appropriate committees of the Association are engaged in the industry's real time transaction reporting and trade matching projects that will result in the automation of inter-dealer trades relating to municipal and corporate bonds.

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* The Bond Market Association represents securities firms and banks that underwrite, distribute and trade fixed income securities and other credit market instruments in the U.S. and globally. Additional information about the Association and its members and activities is located at www.bondmarkets.com.

Our recommended good delivery rules, as amended, have provided clearance and settlement guidance to direct participants in the mortgage-backed securities market for over two decades. In addition, the Association's leadership in operations in the Government securities market has been recognized by the U.S. Treasury Department and the Federal Reserve Bank in connection with numerous initiatives that have fostered systemic safety in the domestic and global securities markets. Most significantly, at the Association, industry leaders always serve as the decision-makers on matters that are likely to have a major bearing on industry practices or trends.

Moreover, our interest in promoting a greater awareness of the benefits of technology in connection with securities processing has led the Association to organize STP and protocols committees. In fact, the Association has served as a principal spokesperson regarding STP in the bond markets since 2000. Other related activities of the Association affecting technology and STP include serving as a resource provider to (1) FIX Protocol, Ltd. regarding the successful development of fixed income securities messaging protocols and (2) The Asset Managers Forum (the "AMF") with regard to AMF's ongoing mission to educate and involve the buyside in the STP movement. AMF's membership includes many of the leading firms in the asset management segment of the securities industry.

Above all, the Association has devoted considerable time and effort to educating its members and others regarding STP and technology. We believe that the goal of automating the clearance and settlement of institutional securities transactions can be achieved pursuant to an industry-sponsored best practices process which is described below in greater detail. Further, the Association believes that bond dealers should plan to develop STP in light of these best practices (including related benchmarks), and invite the SEC to critique these practices and benchmarks at regularly scheduled intervals. On the other hand, the Association believes it is necessary to avoid considering any new or revised regulatory structure that would restrict dealers from doing business with investors whose systems capabilities might be deemed sub par from an STP standpoint.

Trade Confirmation and Affirmation

The Association has in recent years raised the very same questions posed by the SEC in its Release with numerous bond dealers, asset managers and vendors. Invariably, the response given by these market participants is that institutional trades involving fixed income securities should be confirmed or matched at the block level on trade date. This means that the basic terms of the transaction between buyer and seller would be agreed to electronically on trade date. If an online trading system (offered by an alternative trading system) is used by the parties to the trade, then theoretically the parties would be able to effect the equivalent of a locked in trade, and the trade would therefore be confirmed upon being executed (subject to any appropriate changes for corrections or mistakes). If an online trading system is not used, then the parties to the trade should make arrangements to match the trade electronically on trade date by immediately submitting the basic terms of the transaction to an agreed upon and qualified real time securities trade matching facility.

The next essential step, according to virtually all market participants who have been analyzing the confirm/affirm matter for several years at numerous meetings sponsored by the Association, is affirming the trade; that is, in the case of a fixed income securities transaction, the asset manager will affirm the trade to the dealer. However, affirmation occurs only after the parties have agreed upon the breakdown of the block trade to the accounts of underlying parties of the asset manager. In the interest of greater efficiencies, the exchange of information concerning the allocation of securities to these underlying accounts should be done electronically. In fact, to the extent that matching is done on an automated basis, as described above, then allocations and the affirmation itself would be the next steps that the parties would accomplish in this process.

In any event, the prevailing thinking by both sellside and buyside groups is that the risks associated with failing to match at the block level on trade date, from an operations management standpoint, are much greater than the risks that can arise in connection with delays in the allocations process. Accordingly, the Association would recommend that allocations and affirmation should be achieved no later than T + 1 in accordance with best practices to be developed by the leading trade groups that represent dealers, asset managers and vendors. Given that a significant portion of the fixed income market currently settles on trade date or T+1, the Association believes that formal rules in connection with the confirmation and affirmation process might actually impede the progress that has already been made; thus, risk reduction measures should focus on same day block level matching.

We note that some trade groups feel that the Commission should strive to achieve standards similar to those mentioned hereinabove pursuant to formal rules of the Commission. We would suggest that best practices in the bond markets could be pursued until a decision is made concerning the question of whether formal regulations should be promulgated. If the SEC were to adopt rules, then our best practices could possibly serve as a basis for such rules. Nonetheless, we feel very strongly that the inherent diversity of asset management firms would inhibit formal rulemaking; therefore, the Association supports continued progress in the area of Straight Through Processing by allowing market participants to formulate new products and recommended best practices.

Finally, the Association strongly supports the development of messaging standards in order to support the efficacy of our recommendations. The Association and The Asset Managers Forum have been partners with FIX Protocol, Ltd. in connection with the issuance of FIX 4.4. The FIX 4.4 protocols are in the public domain and can be accessed by all market participants. Our recommendations in this comment letter are based on the utilization of FIX protocols by dealers, asset managers and vendors. Thus, we would urge the Commission to endorse these protocols unequivocally.

<u>Settlement Cycle</u>

The Association believes that a mandatory reduction in the current settlement cycle is unnecessary. If the main objectives of a settlement cycle reduction would be to reduce risks and increase efficiency in the securities clearance and settlement process, then it is essential to focus on improving STP-related practices, as opposed to simply changing the cycle. The fixed income industry is currently creating a straight-through processing environment by supporting new initiatives (such as the Fixed Income Clearing Corporation's effort to net the dealer side of institutional trades) and encouraging industry participants to use other automated solutions that are available today. The intrinsic result of these developments might ultimately be a de facto shortened settlement cycle.

The fixed income market is a segmented, heterogeneous market with various asset classes following different settlement cycles and clearing processes; a significant portion of the fixed income market already follows shortened settlement cycle (e.g., U.S. Treasury bonds settle on T+1 cycle and mortgage-backed bonds settle on T+2 cycle), however there are still some products, such as corporate and municipal bonds, that follow a T+3 settlement cycle.[†] The task of changing the systems across the various markets to accommodate a uniform shortened settlement cycle would be one where costs might outweigh the benefits. In the fragmented fixed income markets, where products are often highly complex, a reduced settlement cycle might take away the flexibility that is currently needed in certain asset-backed markets where settlement is subject to delivery of the underlying collateral relating to the securities obligations.

As discussed above, the fixed income securities industry feels that settlement risk is not as great as the risk that occurs when trades are not matched at the block level. Once the block level confirmation is achieved, and trade details are confirmed as soon as possible after the trade execution, settlement risk is less important. In this connection, bond dealers and asset managers have sophisticated procedures in place to make sure that their respective counter-parties are financially sound and able to meet their obligations.

Immobilization and Dematerialization of Securities Certificates

The Association supports immobilization and dematerialization of paper securities certificates. The bond markets are largely dematerialized "book entry only" or "BEO" markets; the benefits of dematerialization are visible in that the transfer of securities ownership is less complicated and less likely to be subject to fraud. The municipal bond markets are an example of successful dematerialization in a very retail oriented market with a large number of outstanding issues. The Association supports the position of the Securities Industry Association ("SIA") in this matter and agrees that the BEO mechanisms mentioned above should be a model for the entire securities industry.

Conclusion

Fundamentally, the Association believes that STP in the institutional fixed income

[†] The Association is currently conducting research to collect detailed data and information to determine which percentage of institutional fixed income trades already follow a shortened settlement cycle. This information will be forwarded to the Commission as it becomes available.

securities markets can be achieved under the following guiding principles:

- That best practices are preferable because the buyside is prepared (by virtue of the leadership of the AMF) to work with the Association in connection with documenting matching and affirmation procedures in a manner that will produce best practices and realistic benchmarks for all relevant parties, including the Commission.
- That the bond markets are presently witnessing major STP innovations (including real time Streetside trade reporting and matching in the municipal and corporate markets which are being sponsored principally by the leading industry utilities); accordingly, it is necessary in the near term for the Association and others to coordinate Streetside RTTM and institutional STP in order to ensure greater operational efficiencies that will reduce processing risks and protect investors.
- That operational efficiencies are directly linked to new industry-wide products that are based on advanced technology; in this regard, we believe that it is prudent for both regulators and trade groups to embrace the development of new fixed income messaging protocols being issued by qualified not-for-profit groups.

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In sum, the Association would like to reiterate its desire to continue to work with the SEC and its staff concerning these matters. Our STP Steering Committee in particular, which took the lead in formulating these comments, would welcome the opportunity to visit with decision-makers at the SEC regarding the nuances of STP if that would be deemed appropriate.

Any questions concerning this matter may be directed to the undersigned or to Ms. Elisa Nuottajarvi, Director of E-Commerce Initiatives at the Association.

Once again, thank you for the opportunity to provide these comments and for your interest in our suggestions.

Sincerely,

Frank DiMarco, Merrill Lynch & Co., Inc.
Chair, The Bond Market Association's STP Steering Committee

cc: Larry E. Bergmann and Jeffrey Mooney
Division of Market Regulation
U.S. Securities and Exchange Commission